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The fiercest company hunter in the oil patch, T. Boone Pickens Jr. hunts smaller game in his spare time; he was stalking quail on his Texas ranch when Arthur Meyerson took the cover photograph. For how Pickens thinks Gulf—and the rest of the oil industry—should be served up, see page 54.

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FORTUNE (ISSN 0015-8259), December 26, 1983, Vol. 108, No. 13. Issued biweekly by Time Inc., 3435 Wilshire Blvd., Los Angeles, Cal. 90010. Second-class postage paid at Los Angeles, Cal., and at additional mailing offices. Subscriptions: U.S., U.S. possessions: one year $39, Canada: one year $49. Address all subscriptions and correspondence concerning them to FORTUNE, 541 North Fairbanks Court, Chicago, Ill. 60611. Principal offices: Time & Life Building, Rockefeller Center, New York, N.Y. 10020. Address correspondence concerning editorial material to FORTUNE, Time & Life Building, Rockefeller Center, New York, N.Y. 10020. J. Richard Munro, President, E. Thayer Bigelow, Treasurer, Charles B. Bear, Secretary. Authorized as second-class mail by the Post Office Department, Ottawa, Canada, and for payment of postage in cash. Member, Audit Bureau of Circulations. POSTMASTER: Send address changes to FORTUNE, Time & Life Building, 541 North Fairbanks Court, Chicago, Ill. 60611. © 1983 Time Inc. All rights reserved. Reproduction in whole or in part without permission is prohibited. FORTUNE is a registered mark of Time Incorporated.

TAPPING THE RICHES IN COMPANY PENSION PLANS

■ The chairman of the House Committee on Aging calls it "pension piracy": the nation's private pension plans, with assets of $600 billion, are being tapped for hundreds of millions by the companies that set them up. Although the practice can be abused, it represents a great opportunity for management and is not nearly as nefarious as it may seem. Companies can recapture money that belongs to them while meeting all contractual obligations to employees. *continued*

Harper & Row $10.2 million
Dentsply Intl. $11.3 million
A.G. Becker $11.1 million
Bank of the Commonwealth $12.0 million
Timex $21.3 million
Lane Bryant $12.3 million
Continental Air Lines $19.6 million
John Crane-Houdaille $18.5 million
Questor $13.3 million
M.W. Kellogg $58.0 million
Western Air Lines $28.8 million

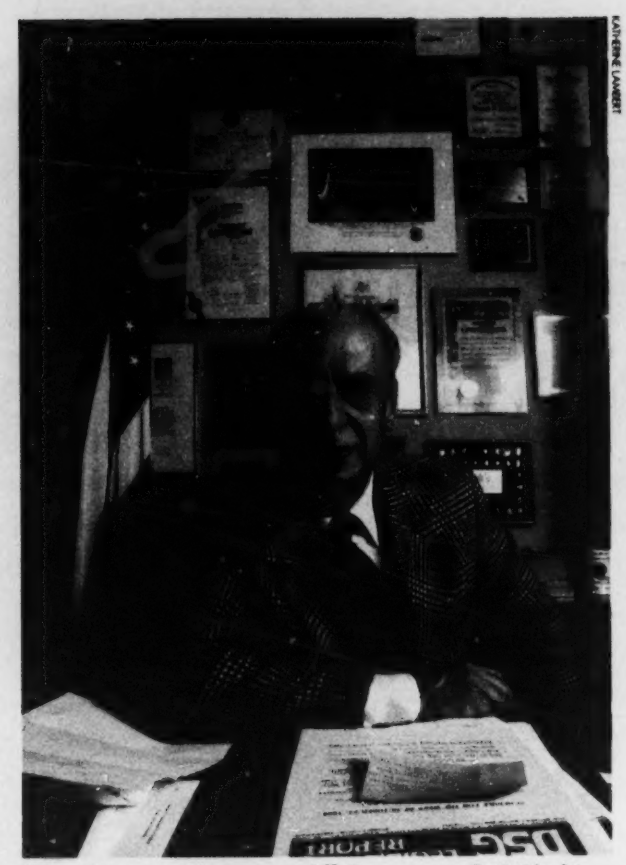
The Companies That Got the Most

Eleven companies had tapped more than $10 million each from overfunded pension plans as of last fall. M.W. Kellogg, now part of Signal Companies, drew off $58 million, the most approved thus far by federal authorities. That's because a highly conservative management—it used to be Pullman Inc.—worked hard at keeping its $123-million plan fully funded and then got a bonanza from the bull market in stocks. The figure for Timex includes amounts reclaimed from three pension funds; the figure for Western Air Lines covers two.

This lucrative activity centers on a new phenomenon: the overfunded pension plan. Many so-called defined-benefit plans, which promise a regular, predetermined payment after retirement, have grown extraordinarily large lately. They contain much more money than is needed, by actuarial calculations, to satisfy any obligations to current and retired employees. Hundreds of companies are taking shrewd advantage of these windfalls by canceling their plans and funneling the excess money into their operating and capital budgets. Most are also replacing their defined-benefit plans with "defined-contribution" plans, under which the company makes fixed payments into the pension fund but doesn't guarantee how much employees will get in retirement.

Just a few years ago *under*funded pension plans were making headlines. Today perhaps only 10% to 15% of the more than 100,000 private defined-benefit plans are underfunded, vs. more than 50% in the mid-1970s, and even some of the most notorious cases are no longer a problem. Perhaps the most notorious of all was the Lockheed Corp. pension plan. Six years ago it fell $276 million short; the plan is now overfunded to the tune of $702 million.

A rare combination of soaring stock prices and high interest rates has brought about the dramatic change. The stock market has inflated the values of pension fund investments, while high interest rates have held down the cost of reimbursing the fund beneficiaries. Companies normally meet their obligations by purchasing annuities for the beneficiaries, and the higher the interest rate the less it costs to buy a particular annuity.



KATHERINE LAMBERT

"People are getting gypped," *Congressman Roybal insists.*

A LOT OF COMPANIES are drawing an awful lot of money from their pension funds. Since 1980, 128 companies have carried out 138 fund "reversions" in which they were able to reclaim at least $1 million each in excess assets, according to figures compiled by the Pension Benefit Guaranty Corp. (PBGC), the federal agency that insures private pension plans. The funds involved in those reversions held $1.3 billion in assets all together, of which $515 million was deemed excess. The PBGC, which has to approve any cancellations, is currently considering applications that would free up well over $1 billion more in excess assets. Beyond that, an estimated $150 billion in excess assets sits untapped in all the other private pension funds. So opportunities await many employers.

Companies are putting the money to varied use. Some are retiring debt, making modest acquisitions, or buying back their own stock. In most cases, the money recovered pumps up reported profits; when a pension plan is tapped, the money flows through the income statement.

Many cancellations are being sought by companies in financial straits. In one of the largest reversions approved so far, Continental Air Lines recaptured $19.6 million last year by liquidating a pension fund with assets of $66 million—a move that didn't forestall Chapter 11 bankruptcy in September.

Plenty of sturdier companies are getting on the bandwagon as well. The largest fund reversion of all is being sought by Occidental Petroleum Corp., whose venerable chairman, Armand Hammer, 85, hardly ever misses a financial trick. Last May Occidental announced plans to "restructure" its pension program by canceling four defined-benefit plans, which contain $541 million in excess assets. Occidental plans to use most of the money to retire some of the $4 billion in debt incurred when it acquired Cities Service Co. last year.

Occidental's fund reversion is comparable in most ways to what is happening throughout the business world. To meet its obligations to beneficiaries of the canceled plans, Occidental bought a group annuity from Metropolitan Life Insurance Co., which guaranteed a 12% interest rate, compounded annually, for the next ten years, with the rate to be renegotiated at the end of that period. The canceled plans are being replaced by a defined-contribution plan.

Unlike most other reverters so far, Occidental has also set up a supplementary salary-reduction—or thrift—plan, and an employee who chooses to participate can have up to 12% of his salary withheld and invested for him in a tax-deferred fund. Occidental will match the employee's contribution up to 6% of salary. Such tax deferments are authorized by the Internal Revenue Act of 1978, whose relevant section has given its name to many so-called 401(k) plans.

Companies that cancel their pension plans aren't required to establish new ones, but they almost always do. Without providing a pension plan of some sort, they would have a hard time attracting or keeping good employees. In one important respect, however, reversions may leave employees with less security than they had before.

Most companies are going the defined-contribution route when they revert, shifting some of the uncertainties about pensions from themselves to their employees. Because the company doesn't have to guarantee the size of the benefit, it isn't obligated to increase its contributions when the fund's investments do poorly. Depending on the fund's performance, employees might get much better pensions than they would have under a defined-benefit plan—or they might wind up with peanuts. But companies are clearly within their rights to make such changes whether or not they have overfunded pension plans.

Legal requirements have to be met before an overfunded pension plan can be tapped. A company can't simply draw off the excess and keep the old plan going, since the Employee Retirement Income Security Act forbids withdrawals from active plans. The law also requires a company to show that its plan became overfunded through "actuarial error"—meaning that the assets increased

RESEARCH ASSOCIATE *Philip Mattera*

more rapidly than the company could have reasonably anticipated. The idea is to prevent companies from contributing lots of tax-deductible money to their pension funds in good times, then reclaiming the money when profits are down.

Though the PBGC is laboring over a backlog that delays decisions for months, it has never refused to approve the cancellation of an overfunded plan. Cancellations also are reviewed by the Internal Revenue Service, which rules on whether they jeopardize the tax-exempt status of money contributed to the funds; approval usually is granted without fuss. Hovering in the background is the Department of Labor, which investigates charges of shenanigans but has never contested the cancellation of an overfunded plan.

DESPITE the firm legal underpinnings, pension fund reversions strike a lot of people as unfair and even unethical. Most of the grumbling comes from union leaders, disgruntled employees, and their allies in Congress. These critics argue that pension plans are created for the benefit of the employees, and if by happy chance the plans become overfunded, the employees should receive the surplus. The critics also maintain that canceling in effect reneges on a promise to employees who joined their companies with the understanding that they would be covered by defined-benefit plans.

A few pension fund reversions are being challenged in the courts. The loss-ridden Great Atlantic & Pacific Tea Co. announced in 1981 that it would cancel its defined-contribution plan. This would have produced a $250-million windfall, not only for the usual reasons but also because A&P had sharply reduced employment. The company planned to use the money to renovate its present grocery stores and build new ones, but it was promptly sued by a retired executive, William I. Walsh, who contended that the excess assets properly belonged to the plan's beneficiaries. His suit later was expanded into a class action.

A&P agreed to an out-of-court settlement in which it promised to let the beneficiaries have $50 million of the excess assets. The settlement was accepted by the attorneys in the class action, and was approved by a federal judge. It has not gone into effect, however; Walsh has appealed, still arguing that the beneficiaries should get all the money.

In perhaps the most controversial case of all, two suits have been filed against Harper & Row, one of the nation's largest book publishers. In December 1981 Harper & Row canceled its defined-benefit pension plan, with the PBGC's approval, and reclaimed over $10 million in excess assets. Management used the excess to help finance the purchase of about a million shares of Harper's common stock, one-third of the total outstanding, which was being put up for sale by Minneapolis Star & Tribune Co., now Cowles Media Co. Harper bought it because "we didn't want to submerge ourselves into a Gulf & Western, Newhouse, or MCA," says Brooks Thomas, 52, Harper's president and chief executive. In August, Harper agreed to pay $20.4 million, or $20 a share. At the time, the company's stock was trading over the counter for less than $13 a share, but Thomas insisted that $20 was a fair price for a controlling block.

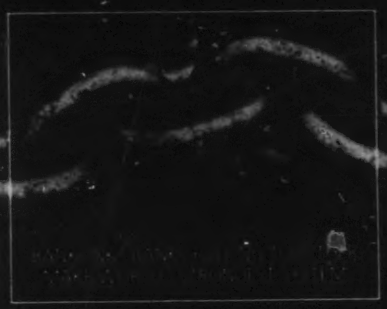
The excess pension fund assets covered only about half the purchase price, so Harper also used $1.8 million that had been allotted to an employee profit-sharing fund, and raised the balance by selling real estate and borrowing from banks. The profit-sharing fund was to receive 15% of the shares, and over five years the balance would go into a newly established defined-contribution plan.

Brooks Thomas offered a sunny interpretation of Harper's actions. By including stock purchased with bank loans and the proceeds from real estate sales, he pointed out, the contribution gave the employees more than they would have got under the old plan. The stock, he said, would "create an identity of interest between our employees and shareholders, which does not normally exist in publicly held companies."

Sharp dissents followed. Raymond C. Harwood, 77, who had served as chairman of Harper & Row until 1969 and was both a pensioner and stockholder, described the price paid for the stock as "excessive" and filed suit against the company. He was joined by Glen Howard, a middle-management executive who has since left Harper. Another suit was filed by District 65 of the United Automobile Workers Union, which represents 280 clerical and editorial employees. The union protested that Harper had used the pension fund as a "piggy bank" to entrench management, violating its fiduciary duties to employees.

Harper offered most employees a choice between an annuity guaranteed by Prudential Insurance Co. and a lump-sum payment representing the current value of the promised future benefits. But the union contended that the lump-sum payments were unrealistically low because they were predicated on an unrealistically high interest rate—15% a year into the indefinite future. Harper's motion to dismiss the suits is being considered by a federal judge in New York.

The Harper case has been a bone of contention in hearings before the House Com-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mittee on Aging, chaired by Representative Edward R. Roybal, 67, of California. Roybal opened one session with a thundering declamation: "A proliferation of these self-interested employer activities is spreading unchecked like some insidious disease, striking down the retirement security of the worker, infecting one employer after the other, while the agencies merely stand by and ponder."

LIGHTNING has yet to accompany the thunder. Those pondering agencies were the PBGC, which didn't send a representative to testify before the committee, and the Labor Department and the IRS, whose representatives testified that they didn't see a serious problem. Alan D. Lebowitz, acting administrator of the Labor Department's pension and welfare benefit programs, told the committee employers should be free to terminate plans they sponsor "as long as the benefits earned by participants and beneficiaries are protected." The regulators are saying, in effect, that a pension fund's excess assets belong to the shareholders, not employees.

The PBGC and IRS *have* taken a jaundiced view of a newly proposed device, the pension "spin-off," in which a company would split its pension plan into two parts—one for the retirees and the other for active employees. Both AMAX Inc. and Stroh Brewery Co. recently filed spin-off applications. Stroh intends to assign all the excess assets to the retiree plan, cancel it, and buy annuities for the retirees. In this manner it would recover the full amount of the excess without having to buy annuities for the active employees, who would continue under the old defined-benefit plan. The PBGC, however, is unsure whether canceling just one part of a plan would be legal. And the IRS might require companies to divide excess assets between both the canceled and uncanceled parts of a plan, which is what AMAX intends to do.

But one way or another reversions are likely to keep increasing as long as pension plans generate surplus earnings. Roybal wants to restrict them, but until he holds more hearings next year he won't predict what form legislation might take. Even then, Congress and the Reagan Administration are unlikely to keep companies from going after those surplus billions.

■ The real question critics should be raising about pension fund reversions is whether or not the money they yield is being put to good use. Properly redeployed, those excess assets can revitalize troubled companies and even save some from extinction—something that employees, no less than employers and shareholders, should consider desirable. F